

### A budget for economic recovery?

**Gary Akehurst**

**Rotterdam School of Management, Erasmus University, The Netherlands**

In a speech lasting just over 57 minutes Alistair Darling presented his third and last Budget before the general election, which is widely expected to be held on 6 May. In presenting a cautious, rather political but essentially workmanlike budget the Chancellor is hoping to delay the real pain of increasing taxation and public expenditure cuts, while recovery hopefully grows stronger in the months to come. Surprisingly, the public finances have improved slightly more than had been expected, which gave a little more room for a £2.5 billion “one-off growth package”.

#### Main Budget measures

- The investment small firms allowance doubled to £100,000
- Business rates cut for 500,00 small businesses for one year from October (of these 345,000 will pay no rates)
- Capital gains tax will not increase and double relief granted for entrepreneurs up to £2 million
- Confirmation of 50% income tax rate from April
- Confirmation of 0.5% rise in national insurance for those earning more than £20,000 pa from April 2011
- Cider duty raised by 10% above inflation
- Duty on beer, wines and spirits up by 1% above inflation
- Tobacco duty raised by 1% above inflation and by 2% each year until 2014
- Doubling of stamp duty threshold to £250,000 for first time buyers and increased to 5% for properties over £1 million from April 2011
- Inheritance tax threshold of £325,000 frozen for four years
- RBS and Lloyds to provide £94 billion in new business loans, 50% of which must go to small and medium-sized businesses

#### The economy

This Budget was expected to be at best broadly neutral (give-aways balanced by increased taxation) and in the event we were not disappointed. The Chancellor of the Exchequer, faced with a record government deficit and an election within weeks, delivered a very low key, skilful but highly political Budget statement. The Chancellor came to his Budget statement with three economic challenges. First, in the short-term to prevent a double-dip recession; second, in the medium-term to present a credible deficit reduction plan and third, in the long-term an aim to make the UK economy rather less dependent on the financial sector.

This was in all honesty a difficult act to pull off, and the fact that following the Budget there were no major runs on sterling and company shares is encouraging. The Chancellor had little room for manoeuvre - the markets would not have tolerated a give-away Budget, and indeed only £1.4 billion is being injected into the economy in 2010-11.

Economic growth is forecast to be between 1 and 1.5% this year, which is roughly in line with expectations but the growth forecast for next year is revised downwards to between 3 and 3.5%, which is in line with Bank of England growth forecasts. Some economic commentators challenge these figures and suggest that

growth will be nearer to 2% but history shows that deep recessions are almost always followed by strong recoveries fuelled in part by considerable excess capacity and under-utilised labour resources. Economic growth is essential in the fight to return government finances to the black but the Chancellor gave little away about how government spending will be pruned and taxes raised to meet long-term government financial targets. To be fair neither has the opposition parties given many details of their tax and spending reduction plans, which all goes to make the voters nervous. Details of public spending plans will be revealed bit by bit by the autumn, whichever political party wins the coming election. The danger is all too apparent that government spending cuts and tax increases too early this year runs the risk of choking off a fragile economic recovery. Government borrowing is planned to reduce from 12% of GDP this year to 4% in 2014-15 but between 2009 and 2015 borrowing will total £734 billion or £12,000 for every man, woman and child in the country. Meanwhile inflation is running well above the 2% government target – 3% using the CPI index or 4.2% using the RPIX index.

## How it affects you

Alistair Darling announced a series of measures in support of small businesses. The annual investment allowance for small businesses has been doubled to £100,000. This was a welcome move. £94 billion of new lending from the part-nationalised banks - the Royal Bank of Scotland (RBS) and Lloyds Banking Group - is promised with around half aimed at small and medium sized businesses. Again this is a welcome move as bank lending has continued to be rather constrained in the aftermath of the financial turmoil of 2007-2009. However, if RBS and Lloyds fail to meet the £94 billion lending target executive bonuses would be stopped. However, the Chancellor said that Lloyds and RBS had lent £38 billion to small and medium sized enterprises (SMEs) over the past 12 months. Increased banking competition generated by the award of new banking licenses (which should see for example, a Tesco retail bank) and the sell-off of 900 RBS and Lloyds branches should make access to credit better for small businesses. A “credit adjudicator” has been formed which provides an appeals process for small firms who feel they have been unfairly turned down for bank loans.

A Growth Capital Fund was announced, providing investment for fast-growing businesses. This fund may eventually be worth £500 million. We await further details.

Under the business rates changes the government is funding a temporary increase in the level of rate relief so that small firms occupying properties with rateable values up to £6,000 will pay no business rates for a year from October. So 345,000 small firms will pay nothing for a year. The Time to Pay scheme has been extended, allowing firms in difficulties to spread tax payments, thus making them more affordable. This initiative had been launched in 2008 and some 200,000 companies have been able to spread £5.2 billion of payments. The Chancellor announced that the scheme would be extended over the entire life of the next parliament.

The Chancellor has promised that the government would increase the contracts it awards to SMEs by 15%; this means an additional £3 billion of awarded business from central government and a further £15 billion from the public sector. In addition the government has pledged to pay 80% of invoices within five days. The Chancellor said that the array of already existing initiatives for small firms would be streamlined under the auspices of one organisation - UK Finance for Growth, which will have oversight of some £4 billion existing schemes.

Recently concerns had been expressed about the relief given to entrepreneurs on capital gains. At present owners of businesses pay 10% on gains up to £1 million rather than the usual 18%. The Chancellor doubled the threshold to £2 million. He also increased the minimum wage from £5.80 an hour to £5.93, an increase of 2.2%, on the recommendation of the Low Pay Commission. Many employers had called for a freeze given the financial difficulties of many businesses but the British Retail Consortium said the increase was “excessive” when compared with average retail pay rises of 0.7% but the hospitality industry has many minimum wage employees and costs will inevitably rise which may be difficult to pass across to customers in higher prices.

The Chancellor confirmed that the duty on beer, wine and spirits will rise, as planned, at the start of April by 2%. This will add around 2p to a pint of beer, 10p on a bottle of wine and 36p on a bottle of spirits. However, in an unexpected blow to the cider industry he also said that cider has been under-taxed compared to other drinks (although the duty had been reduced some years back by the previous Chancellor). Accordingly, the cost of cider will rise by 10% above inflation from 28 March, while in September he made it clear that the definition of "cider" will be changed so that strong cider is taxed "more appropriately" – a clear sign of substantially increased duty. The pub sector will feel this is a particularly difficult measure to bear. Tobacco duty has been increased by 1% above inflation and 2% in real terms every year until 2014.

## Other measures

A two year stamp duty exemption for first-time buyers purchasing a property costing less than £250,000 was announced, which is good news for first-time buyers and the whole property market. The measure is worth up to £2,500 which can make quite a difference. The previous stamp duty holiday (on property worth up to £175,000) helped around 260,000 buyers but to recoup the lost revenue, stamp duty will rise permanently from 4% to 5% on properties costing £1 million or more from April 2011.

With rising oil prices and resulting large increases in petrol and diesel prices in recent weeks the Chancellor decided to stagger planned fuel duty increases to "ease the pressure on family incomes". Duty had been planned to rise by 3p a litre but will now be increased in three stages – first a 1p increase from 1 April, another 1p on 1 October and 0.76p on 1 January 2011. The AA reckons monthly household fuel bills increased by an average £50 last year and the fuel bill for each car will rise by £38 a year after the April increase alone. More pain for motorists will follow as the government is committed to "the fuel duty escalator" – the policy of increasing fuel duty in future years, so that fuel prices will rise by inflation plus 1p a litre every April until 2014 (and in all probability several years after that).

As expected, the Chancellor announced plans to tackle financial inclusion by making sure everyone has access to a basic bank account which enables credits and direct debits to be set up but no cheque book or overdraft facility. He said this will mean a further 1 million people will be able to open an account over the next five years. Around 1.75 million adults do not have a bank account, many are too young to pay national insurance or are retired.

While income tax basic rate was left at 20% and higher rate at 40%, people will pay more income tax because personal allowances are frozen in 2010-11 at £6,475, as had been announced in the 2008 Budget. Higher rate taxpayers face frozen allowances until 2013. Couple this with frozen or reduced pay for many people and real disposable incomes are set to be squeezed hard over the next tax year particularly if, as expected, interest rates start to rise and possibly reach 6% in a couple of years. This is the hidden blow which is yet to be felt. As previously announced from April all earnings over £150,000 will be taxed at the "additional rate" of 50% but people earning £100,000 or more will also suffer as the basic personal allowance will be reduced to nil for people on an adjusted net income over £100,000. Those who earn between £90,000 and £125,000 will suffer an effective tax rate of 60%.

Public sector pay increases will be held at 1% for two years from 2011 and various government efficiency drives have been announced, with 15,000 civil service jobs relocated outside London over the next five years.

The inheritance tax threshold is frozen at £325,000 for the next four years. As house prices start to rise again many more people will be feeling the effects of this tax.

From April 2012 parents of children aged under two will receive £4 more a week in child tax credit. The scheme which guarantees a job or training for every 18 to 24 year old after six months

unemployment has been extended to March 2012. This is to be welcomed as young people have particularly felt the brunt of unemployment as have older workers aged over 50. For the over 60s the Chancellor has made it easier to claim working tax credit by reducing the number of working hours needed to qualify.

The government proposes to establish a Green Investment Bank with £2 billion for projects that might be unattractive for the private sector, such as offshore wind farms and other low carbon projects. The Bank could also finance new nuclear power and some railway projects but some commentators believe that some £200 billion will be needed to invest in a new energy infrastructure over 10 years. The initial £2 billion fund will be financed by £1 billion from selling the Channel Tunnel rail link, the Dartford Crossing, the Student Loan fund and the Tote, and the other £1 billion raised from insurance companies, pension funds and other investment vehicles.

British Waterways are to be released from state control, allowing it to raise funds and investment independently. British Waterways could become a more significant player in leisure markets if it can capitalise on its 2,200 miles of canals and rivers.

Finally, £35 million has been pledged to a new university enterprise capital fund to assist university sponsored businesses and a £270 million university modernisation fund to create some 20,000 university places in subjects such as science.

## Conclusions

Some people are of the view that this year's Budget is far too cautious about current year finances and far too optimistic over future reductions in public debt. A suspicion lingers that none of the main political parties are telling the whole truth about the measures which will need to be introduced later this year in a major effort to balance the government's books. Speculation that VAT may rise to 20% to bring the UK in line with major Eurozone countries may or may not materialise, and there is no denying this would raise significant revenues but the Chancellor has attempted to help some of the more vulnerable members of society at a time of great hardship for many families. Meanwhile inflation is creeping up again, partly because of the programme of quantitative easing, where the Bank of England has injected over £200 billion into the economy. The prospects of a hung parliament after the general election are making the financial markets nervous although many countries exist quite happily with coalition governments. For the hospitality industry the rest of this year will be a trying time as consumers face the inevitable belt tightening which will follow the current political impasse in the run up to the general election.